A. Well, from ACI's competitors like AT&T and Sprint and MCI, yes.

Q. No. No. No. I'm talking about Ameritech Michigan information.

A. Yes. But remember -- I mean, this is a point I made last time. The fact that ACI and Ameritech are competitors is purely ancillary to the fact that ACI is trying to go and compete against AT&T. I think it's more proper from an economic point of view to see ACI as primarily a purchaser from Ameritech. So it's more a buyer-supplier relationship rather than a competitive one. That just sort of is ancillary fallout to the fact that they're trying to design a business model that will enable them to go compete against AT&T, MCI, Sprint and the other long distance carriers.

Q. And so the focus of the Commission should be on setting up an entity that can compete against AT&T; correct?

A. I'm not saying precisely that. I'm saying to understand why the certification is important. I think you have to recognize what the fundamental strategic thrust here is, and that's to go compete in the long distance market. Now, I mean, there's lots of things the Commission has to consider, but if it doesn't do so in that context I think it would be hard to understand what's really going on here.

6 Tr 1088-1089 (Emphasis added) As Dr. Teece's testimony clearly demonstrates, Ameritech's true objective is to compete in the long distance market. The focus of Ameritech Communications' business concern as relating to the provision of long distance service becomes even more evident as Teece continued his testimony:

Q. How would a competitor, MCI or Comcast, know if the deal they had negotiated was different from the deal that ACI had negotiated?

A. Well, I would just simply point out that if they weren't given the same deal, if there was discrimination, it would be actionable. So they would have some confidence that they would be presented the same deal if they were looking for something in that neighborhood because, otherwise, Ameritech would be in violation of the discrimination rules.

Q. And so your -- it's your position that Ameritech basically will never violate the discrimination rules or --

A. Well, no, not necessarily, although I would hope that would be the case. There's all kinds of penalties, and, as I said before, there is the -- the larger environment here is one where Ameritech is trying hard to get permission to compete in long distance, and if there's a litany of evidence that they have not been in compliance, they won't be able to get what they're truly after.

6 Tr 1096 (Emphasis added)

Dr. Teece then again reiterated Ameritech's true intentions to serve the long distance market and the effect of approval of a license in this case with respect to its ability to provide interLATA long distance service in the future:

Q: With respect to the time line under consideration as part of this application and as part of what we've been discussing with the federal checklist, is there a point in which -- let's say hypothetically ACI received approval for local service here in Michigan, correct, okay?

A: Okay.

Q: Then -- first of all, as soon as they receive approval under the obligations of being certificated, one has to be ready and open for business; correct? You have to -- if somebody asks you for service, you have to offer it; correct?

A: Yes.

Q: Okay. Now, with respect to the federal checklist on long distance, that might take a little bit longer; correct? That might take into '97 perhaps, we don't really know; isn't that right?

A: Well, they're not on the same clock. It's an independent clock.

Q: So we have two different time elements here for two different activities; correct?

A: Yes.

Q: Okay. What is it that ACI is going to be able to do that Ameritech would not be able to do in the local sphere during this time of lack of uniformity on the time schedule?

A: I'm not quite sure what you're asking. Are you saying --

Q: For 1996, for instance, hypothetically if ACI had approval --

A: Yes.

Q: -- why would it be any different that Ameritech for local service in terms of what it could do versus what Ameritech could do?

MR. DEMLOW: Again, your Honor, does counsel mean Ameritech Michigan?

Q: (By Mr. Rowland) Excuse me, I apologize, Ameritech Michigan.

A: I don't think there would be any basis for significant differentiation.

Q: Okay. When you speak of efficiencies, one of the efficiencies that you're talking about in your testimony has to do with cost savings; is that correct?

A: Well, efficiencies result in cost savings.

Q: Okay. So for the period when we had two -- under my hypothetical we have two companies operating at the same time, we might have increased costs, not fewer cost; correct?

A: Well, no, I don't see why it would have been any higher. I mean, if you're asking because we've got certification in the local exchange does that imply if they have that before they have clearance to compete long distance does that imply higher costs. No, I don't see that implication following. I mean, it may enable them to get ready to compete in the long distance market with more certainty about the outcome.

Q: But if we have employees working for Ameritech Michigan, at the same time we have employees working for ACI essentially doing the same types of activities, we have two costs; correct?

A: Well, I wouldn't expect duplication of that kind. And if ACI did have the permission to enter the local -- had local certification before it had permission to go long distance, it's not necessarily going to spend money for the sake of it. I mean, it's going to, as I understand it, prepare to compete in the long distance market.

6 Tr 1107-1109 (Emphasis added). In continuation of his cross-examination, Dr. Teece then demonstrated how important it is to Ameritech to obtain a license in this case with respect to its true objective of competing in the long distance market:

Q: Okay. Thank you.

Dr. Teece, I heard earlier today, and correct me if I'm wrong, when we were talking about discrimination the fact that a company would not discriminate because there is a penalty out there. Is that essentially what you were saying, that there's a penalty on the law, therefore, one would not engage in it?

A No. There's really two things. The one that I emphasize in my direct testimony, I think, is more powerful, and that is it's not an efficacious strategy. The best way to get ahead in markets, particularly in this new long distance market, is to compete head on with your competitors. And there's tremendous focus on the possibilities of discrimination. But if a company was to take that and say, "Well, gee, the way I'm going to win in this market is by going the discrimination route rather than competing for customers through offering superior products at better prices" -- I mean, if you ask me as a business school professor which one would a sensible CEO recommend, which one would a student talk about with enthusiasm, certainly wouldn't talk about the discrimination story. So that's point one.

Point two is, yes, that there are penalties and -- in the total. It's not just sort of the narrow penalties that are specified in the act, but here a company is trying ultimately to get approval to go into the long distance business from the FCC and the Department of Justice, and if you walk in with a litany of -- with a long tail of discrimination accusations, I would say the chances that the Department of Justice is going to see that letting you into the long distance business is in the public interest are certainly less than they would otherwise be, and given the magnitude of what's at stake here I cannot believe that that doesn't temper what managers want to do.

Q: If the time line was such that a Bell operating company or GTE received approval to get into the long distance business and some of these issues on discrimination might not have been well documented until after the fact, the Bell operating company is already in the long distance business; correct?

A: Yes.

6 Tr. 1115-1116 (Emphasis added).

The testimony of its own witness Dr. Teece makes it abundantly clear that Ameritech Communications appears less concerned about obtaining a license to actually provide local exchange service in Michigan than it does with obviating the federal competitive requirements to jump into the interLATA long distance market. The Commission should therefore reject Ameritech Communications' license application in this case since Ameritech is apparently attempting to bootstrap an approval of a license in this case as sort of *fiat accompli* with respect to future compliance of competitive requirements with its entry into the long distance market.

II. AMERITECH COMMUNICATIONS' AFFILIATE RELATIONSHIP WITH AMERITECH RAISES SERIOUS CONCERNS AS TO WHETHER GRANTING A LICENSE TO AMERITECH COMMUNICATIONS FOR BASIC LOCAL EXCHANGE SERVICE MAY BE CONTRARY TO THE PUBLIC INTEREST

Section 302(1)[4] of the Michigan Telecommunications Act ("MTA") sets forth the criteria for approving an application for a license to provide or resell basic local exchange service as follows:

[4]MCL 484.2302(1)

> (1) After notice and hearing, the commission shall approve an application for a license if the commission finds both of the following:
>
> (a) The applicant possesses sufficient technical, financial, and managerial resources and abilities to provide basic local exchange service to every person within the geographic area of the license.
>
> (b) The granting of a license to the applicant would not be contrary to the public interest.

In Paragraph 19 of its application in this proceeding, Ameritech Communications lists the various affiliate requirements contained in the FTA, and then states that these requirements along with requirements contained in the Michigan Telecommunications Act ("MTA") purport to provide any needed safeguards to ensure that the granting of a license to ACI for basic local exchange services will not be contrary to the public interest. In support of this assertion, Ameritech Communications offers the testimony of M. Ryan Julian, Ameritech Communications' Director of External Affairs, *4 Tr 548*, and Gregory J. Dunny, Vice President of Marketing and Sales - Network Providers for Ameritech Information Industry Services ("AIIS"), <u>which is a business unit of Ameritech</u> that has responsibility for providing sales and service to other telecommunications providers in all states in which Ameritech provides local telephone service. *3 Tr 273, 275* In his direct testimony, Mr. Julian sets forth various "planning principles" as "safeguards" that he claims Ameritech Communications has used in conjunction with its affiliate relationship with Ameritech Michigan with respect to the provisioning of local exchange service in Michigan. *4 Tr 555-556* Mr. Julian then refers to certain "structural safeguards" which he contends will ensure that Ameritech Communications operates independently of its affiliate Ameritech Michigan. *4 Tr 557-558* In his direct testimony, Mr. Dunny describes Ameritech Michigan's "planned operating relationship" with Ameritech Communications.

and contends that this "planned" relationship demonstrates that the structural separation requirements in the FTA and the MTA, as will purportedly be carried out by Ameritech Michigan, are adequate to "protect consumers and ensure the growth of competition." *3 Tr 275-286*

A. Ameritech Communications Has Failed to Demonstrate That the Structural Separation and Other Statutory Requirements Alone Will Be Sufficient to Protect Consumers Against Affiliate Abuse Or to Ensure the Growth of Competition

As noted above, Ameritech Communications witnesses Julian and Dunny assert that their descriptions of Ameritech Michigan's "planned" operating relationship with Ameritech Communications demonstrate that the structural separation and other requirements embodied in the FTA and the MTA, as they may be carried out by Ameritech Michigan, sufficiently protect customers and ensure the growth of competition. Several independent expert witnesses in this case demonstrate, however, that this is not the case. TCG Detroit's expert witness Dr. Paul Teske[5] testified:

> Q. Do you agree with ACI Witness Dunney (sic) that the structural separation and other requirements embodied in the FTA will "protect consumers and ensure the growth of competition?"
>
> A. No, I do not agree. Ameritech Michigan, ACI's affiliate, has, by its own admission not met the requirements of the FTA with respect to structural separation requirements, and it has not obtained approval to provide in region interLATA service.

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[5]Dr. Teske is eminently qualified to comment on the public interest aspects of Ameritech Communications' request for a license to provide basic local exchange. Dr. Teske is an Associate Professor of Political Science and Public Management of SUNY Stony Brook, where he specializes in political economy. He is also an Affiliated Research Fellow with the Columbia University Graduate School of Business, Institute for Tele-Information. *5 Tr 902* He has conducted much of his academic research on state telecommunications regulation and has written a book and several articles and other literature on the issues of state telecommunications regulation and telecommunications policy. *5 Tr 902-903*

I do not see how ACI can then assert that it has met these same requirements or that they are sufficient to protect customers.

5 Tr 906 AT&T Communications of Michigan, Inc. ("AT&T") witness Cathleen M. Conway, AT&T Corporation's Regulatory Manager in its Central Region Government Affairs Division, similarly testified:

Q. Was ACI formed as a separate subsidiary for purposes of providing basic local exchange service?

A. No. ACI witness Julian states that "ACI was created with the expectation that any freedom from the long distance (interLATA) restriction of the Modification of Final Judgment (MFJ) would require that long distance service be provisioned through a separate subsidiary." (Julian Vol. 4 Tr 552) He goes on to state that it is his understanding that the federal Telecommunications Act of 1996 requires a separate subsidiary safeguard for the provision of interLATA service by a Bell Operating Company ("BOC").

Q. Are the safeguards of the federal Act appropriate to protect the public interest from the possibility of anti-competitive conduct by Ameritech in the local exchange market?

A. As indicated above, the separate affiliate safeguard in the federal Act applies to the separation of the incumbent's local exchange business from the interLATA business. The federal Act is not directed at the situation presented to this Commission by the ACI application, that is, the provision of local exchange service by two competing affiliates, especially when one of those affiliates is the incumbent local exchange company.

5 Tr 964-965

AT&T witness Lee Selwyn, President of Economics and Technology, Inc., a telecommunications research and consulting firm, also underscores the point that structural separation does not adequately protect against anti-competitive conduct by Ameritech in the market for basic local exchange. In recommending that additional affiliate safeguards be established for Ameritech Communications with respect to its license, AT&T witness Selwyn explained that the separate affiliate requirements in the FTA address the relationship between a Regional Bell Operating Company (RBOC) and the interLATA affiliate, but they do not address what relationship or safeguards should exist when the same affiliate is also set up to provide local service or "one-stop shopping" service. *5 Tr 785* Selwyn explained further that it was important to recognize that Congress established these separate subsidiary requirements specifically to prevent RBOCs from extending their monopoly market power in the local exchange market into the long distance market, and that Congress expected certain safeguards to remain in effect for the three year period during which the separate affiliate requirement remains in place in order to protect against anti-competitive behavior by the incumbent monopoly RBOC. *5 Tr 785-786, 812-813*

B. Despite the Existence of the Structural Separation Requirements Embodied in the FTA and MTA, Ameritech Communications, Ameritech Michigan and Their Affiliates Can Still Undertake Anti-competitive Behavior to Gain an Unfair Competitive Advantage in the Market for Local Exchange Service

It must be stressed that the statutory separate affiliate requirements do not generally solve all the potential problems inherent in the expansion of an incumbent monopoly firm, such as Ameritech Michigan, into a competitive market, such as that for interLATA service. TCG Detroit witness Teske explains:

> The parent monopoly firm has an incentive to provide an advantage to a new competitive affiliate venture, and no structural separation or policing policy can be expected to completely prevent such behavior. In addition, in a situation in which numerous affiliates exist, such as the intermediary role played by Ameritech Information Industry Services (AIIS), which would be the actual provider of Ameritech

Michigan services to ACI, the potential for anti-competitive behavior to gain a competitive advantage is increased.

5 Tr 907 Dr. Teske, as well as other witnesses in this proceeding, identified numerous types of anti-competitive behavior which the Ameritech affiliates could undertake, enabling them to gain an unfair competitive advantage to Ameritech and impeding the emergence of competition in Michigan.

1. There is a significant potential for cross-subsidization by Ameritech of its affiliate Ameritech Communications

First, there is a significant potential for cross-subsidization of the competitive affiliate by the monopoly parent, including transfers of revenues and assets from monopoly parent Ameritech to the affiliate, Ameritech Communications, *5 Tr* 739-740, *793-807, 907, 909* and the provision of non-service advantages to the affiliate such as sharing customer proprietary network information, sharing sales personnel and sales referrals, assistance in product development and marketing, access to databases, and provisioning of billing and support systems and repair and maintenance. *5 Tr 907 ,968* Indeed, Ameritech Communications witness Julian presents a fairly comprehensive list of services which may be shared by Ameritech Communications, Ameritech Michigan or other affiliates, including, but not limited to: accounting and financing services, staff, and facilities; human resource services, staff, and facilities; accounting, financial, and human resource transaction processing and data accumulation, staff, and facilities; auditing, legal, pension, public affairs and labor relations services, staff, and facilities; tax compliance services, staff, and facilities; insurance policy coverage under Ameritech umbrella policies; and "general corporate oversight inherent in a parent/subsidiary relationship." *5 Tr 560*

The record is replete with further evidence indicating the potential for cross-subsidization by Ameritech of Ameritech Communications. First, Ameritech Communications represents that its parent Ameritech will be providing the full financial backing to Ameritech Communications and stand behind its financial obligations in order to get its operations running and to provide service to each person requesting service in the territories which it intends to serve. *4 Tr 399-40; ¶¶ 8 and 11 of Application* Ameritech Communications also states, however, that in doing so it will not encumber or pledge any of the assets of Ameritech's local exchange operations. *4 Tr 400, 423* However, Ameritech Communications' Vice-President of Finance and Administration, Patrick Earley, testified that he does not know which financial assets of Ameritech's local operations will not be pledged or otherwise encumbered. *4 Tr 423.* He also does not know what financial and managerial resources would be required to provide service to each person requesting service in the Michigan exchanges to which the requested license pertaining. *4 Tr 419.* Mr. Earley testified that Ameritech Corporation had already loaned, as of the date of his testimony, approximately $90 million in investments to Ameritech Communications. *4 Tr 426* However, he could not identify how much of that investment is related to providing service in Michigan, *3 Tr 449* he could not identify whether Ameritech had a maximum or minimum financial commitment to Ameritech Communications, *4 Tr 442* and he could not determine how much of Ameritech's financial commitment would be targeted to local exchange service versus long distance service. *4 Tr 440-441*

Particularly troubling about Ameritech's investment in Ameritech Communications to date, and thus how much of a potential there appears to be for cross-subsidization to occur, is how cavalierly Ameritech is providing these investment monies to Ameritech Communications. For example, it was startling for the parties to discover during cross-examination of Ameritech Communications' financial witness, Mr. Earley, that all of the money which was being provided by Ameritech to Ameritech Communications to date has been in the form of unsecured debt, and that these monies were provided pursuant to an oral agreement only; there apparently is no written document which describes terms and conditions of these loans. *4 Tr 455.* This may explain why Mr. Earley could not identify what the terms of these loans are nor what the payback period is. *4 Tr 456* Mr. Earley also testified that the $90 million of charges incurred to date by Ameritech Communications was split between direct versus non-direct charges, however, he could not identify the split between these charges, and that Ameritech Communications did not produce with its application in this case any documents, including an annual financial statement or balance sheet, which might help to identify the split between direct versus non-direct charges. *3 Tr 426-428*

TCG Detroit witness Teske's testimony encapsulates why these affiliate transactions between Ameritech and Ameritech Communications are cause for concern:

> Q. What statements of ACI witnesses confirm that there are no checks on the transfer of resources and assets between ACI and Ameritech Michigan?
>
> A. ACI witness Earley states in cross-examination that some expenses are not being incurred directly by ACI, but rather are being incurred indirectly. (Tr. at 425, ln. 18). He identifies the expenses being incurred indirectly as "the time for various support groups that may be happening throughout Ameritech that are capturing that time and cross-charging it to ACI." (Ibid). In contrast, Mr. Earley states that ACI is directly incurring the payroll for the "200 or 200-plus dedicated employees" of ACI. (Tr. at 425, lns. 15-17). He later states that ACI has no employees "at this point." (Tr. at 451, lns. 5-6). In combination these statements suggest that Ameritech Michigan, or another one of its affiliates, have employed more than 200 people solely as a resource for ACI, and in addition, are providing support from other Ameritech Michigan personnel.
>
> Mr. Earley states that the total amount of charges incurred to ACI to date is approaching $90 million, but that he doesn't "have a split of direct versus non-direct" expenses. (Tr. at

426, lns. 8-18). In addition, he states that the internal management reports supported by the underlying detail needed to identify the directly incurred versus the indirectly incurred expenses were not provided in ACI (sic) Application.

Q. Can you explain why these statements are a cause for concern?

A. Yes, First, when read together, it is my opinion that Mr. Earley has stated that cross-subsidies from Ameritech Michigan to ACI have taken place, and continue to take place. Second, he states that not only is he, as Vice-President of Finance for ACI, not aware of their magnitude, but that the information needed to identify the magnitude of the transfer of expenses incurred by ACI and absorbed by Ameritech Michigan has not been provided to the MPSC in ACI's Application.

Q. Are there other statements of ACI witnesses that cause concern about the affiliate transactions between Ameritech Michigan and ACI?

A. Yes, Mr. Earley states in cross-examination that ACI "will be acquiring assets in numerous fashions, either directly or indirectly" and that "up until that time we do start servicing customers there may be an occasion where we acquire them on an indirect basis." In addition, Mr. Earley states that ACI has been funded by Ameritech in the amount of approximately $90 million on an unsecured basis, and that "in excess of 95" of this amount is debt. He states that first, there is no written agreement to reflect this debt funding, and second, that the time period for payback of the debt is unspecified. (Tr. at 455, ln. 6 to 456, ln. 23).

Q. Please explain why these statements are a cause for concern.

A. My understanding of Mr. Earley's statement regarding asset acquisition is that ACI will acquire assets "indirectly" through the mechanism of having Ameritech Michigan incur expenses to acquire assets for the use of ACI. <u>This is a textbook case of cross-subsidy, and definitely eradicates any notion that Ameritech Michigan and ACI are operating as separate affiliates. Mr. Earley's statements regarding the funding of</u>

ACI through Ameritech Michigan debt without a written agreement, or any plan to pay back the funds, classifies this arrangement as more of a gift than a loan, or other bona fide financial arrangement. ACI is a separate affiliate of Ameritech Michigan only in form, but not in practice. Of equal concern is the appearance that ACI's executive officers are oblivious to the need for the separate affiliate transactions between Ameritech Michigan and ACI.

5 Tr 911-913 (Emphasis added)

2. There is a significant potential that Ameritech Michigan in providing services will discriminate in favor of its affiliate Ameritech Communications over other competitors

Ameritech Communications represents that it intends to provide basic local exchange service on a resold basis, and that it may purchase such services for resale from its affiliate Ameritech Michigan. Indeed, Ameritech Communications witness Teece admits that Ameritech Communications is more likely to buy from Ameritech Michigan than other potential providers of local exchange service. *3 Tr 203* Mr. Teece's admission raises the very real concern that Ameritech Michigan is capable and willing to discriminate in favor of its affiliate Ameritech Communications over other purchasers of basic local exchange service for resale and thus better secure Ameritech's dominance in the basic local exchange market as well as use this leverage to gain a competitive advantage in the market for "one-stop shopping" of bundled local exchange and interLATA service, which is what Ameritech Communications' purports to be as its business focus. Ameritech Communications attempts to assure the Commission in its presentation in this case that it will not receive more preferential treatment or more favorable rates, terms or conditions than any unaffiliated competitor. *3 Tr 277, 283; 4 Tr 554* However, Ameritech Communications witness Julian admitted that they have no plan in place to determine whether it is in fact getting better service from Ameritech Michigan than another unaffiliated carrier so as to ensure non-discriminatory treatment. *4 Tr 609*

Despite Ameritech Communications' and Ameritech Michigan's empty assurances to the contrary, the fact of the matter is that Ameritech has an incentive and the ability to provide services to other affiliates at more favorable rates, terms, and conditions, at better quality, and in a more timely manner than to unaffiliated competitors. *5 Tr 907* TCG Detroit witness Teske explains:

> Q. Could Ameritech and its affiliates gain a competitive advantage through the provision of services at more favorable rates, terms, and conditions, at better quality, and in a more timely fashion to its affiliate ACI than to an unaffiliated competitor?
>
> A. Yes, Ameritech has an incentive to provide services in a way that discriminates in favor of its corporate sibling. This is true for a broad range of critical services and functionalities that ACI's competitors require, including interconnection arrangements, unbundled network elements, number portability services, and accesses to databases. Non-service advantages can also be provided to ACI. For example, the assignment of Ameritech personnel to ACI transfers valuable experience and knowledge of Ameritech's business operations to ACI. Although not all of ACI's officers came from Ameritech, about 40% did come directly from Ameritech to ACI. Further movement of personnel between the two affiliates creates the very real possibility of inappropriate information sharing.

5 Tr 908-909

3. There is a significant potential for Ameritech to use its monopoly leverage to exploit market segmentation and impede competition.

Ameritech Communications' affiliate relationship with Ameritech Michigan, and its status as a duplicate affiliate which would provide local exchange service on a resold basis (or through a facilities-based service) and interLATA service, raises special cross-subsidization concerns and may cause Ameritech to gain an unfair competitive advantage in the markets for the provision of local exchange service as well as interLATA service. The granting of a license to Ameritech Communications without appropriate safeguards and conditions to protect against cross-subsidization and preferential treatment would allow Ameritech to capture Ameritech Michigan's local exchange customers in areas where potential competitive alternatives exist, even before such competitors are able to get a foothold in the market. TCG Detroit witness Teske explains:

> Considerable harm to the public interest could result from the establishment of duplicate affiliates to resell local exchange service in Michigan. In the short-run, while ACI relies entirely on reselling Ameritech Michigan services, ACI could receive more favorable rates for resold services than those available to competitors. <u>ACI would be able to capture all of Ameritech Michigan's local exchange customers in areas where a potential competitive alternative exists, by undercutting not only Ameritech Michigan/ACI's competitors, but by undercutting Ameritech Michigan's tariffed local exchange rates</u>. Thus, ACI would be able to prevent the emergence of competition, and Michigan consumers would be prevented from gaining the advantages of a marketplace with viable, non-affiliated competitors.

5 Tr 915-916 (Emphasis added)

Indeed, the use by a monopoly of its affiliate is a rationale economic decision of the monopoly which would necessarily seek to maintain its existing market share. Again, Dr. Teske explains:

> A rational strategy on the part of a monopolist such as Ameritech Michigan <u>would be to preserve its market share and stymie the emergence of competition by creating is own "competitive" alternative</u>, and cleanly dividing Michigan ratepayers into customer of two separate entities; those for whom a potential competitive alternative exists, and those for whom a potential competitive alternative does not exist. Michigan ratepayers in the competitive areas could receive lower local exchange service rates than the tariffed rates they formerly received under the Ameritech Michigan tariff, while ratepayers in monopoly areas would still be subject to

> "geographic deaveraging" and would receive new, higher rates than the local exchange service rates formerly received under the Ameritech Michigan tariff.

5 Tr 916 (Emphasis added)

Ameritech Communications' witness Teece attempts to diffuse these concerns by asserting that price caps on monopoly basic local exchange rates would address concerns about cross-subsidization of affiliates. *3 Tr 164* Ameritech Communications' position, however, is superficial and unsatisfactory. Price caps on Ameritech Communications' sister corporation Ameritech Michigan's basic local exchange service rates would not necessarily be sufficient to prevent Ameritech from using Ameritech Michigan's monopoly resources to cross-subsizide or provide other advantages to its affiliates' competitive ventures. TCG Detroit witness Teske explains:

> While price caps help prevent the firm from raising capped basic local exchange services rates to subsidize interexchange service, as suggested by ACI witness Teece, they cannot address non-price concerns. Although such discrimination is meant to be prohibited as a matter of federal public policy, price caps do not eliminate the possibility of Ameritech providing better service quality, in a variety of dimensions, to its own affiliate than to other competitors in the marketplace. In addition, Ameritech could have its affiliate ACI pursue the more competitive sectors of the market, lowering prices only for those customers. This could leave other customers, who are less well-informed or in less competitive areas, without the advantage of competitive price reductions and, potentially, with lower service quality or without investments in service upgrades. For example, Ameritech incorporated ACI in 1994; since then Ameritech Michigan has invested less capital per year in its network than in any of the previous ten years.

5 Tr 908

AT&T witness Dr. Selwyn testified as to similar concerns about placing too much emphasis on price limits on monopoly services under Michigan's regulatory scheme. Dr. Selwyn testified that

Michigan's regulatory scheme does not effectively constrain price increases of Ameritech Michigan's monopoly services nor prevents Ameritech Michigan from raising these prices so as to allow it or its affiliate Ameritech Communications to lower prices of competitive services without reducing overall revenues to Ameritech Michigan or its parent Ameritech Corporation. *5 Tr 796, 798*

In fact, there is ample evidence to show that Ameritech is already taking steps to potentially exploit the segregation of the "competitive" and monopoly local exchange service markets in Michigan. Dr. Teske testified:

> Q. Is there any evidence that Ameritech Michigan intends to restructure its local exchange service rate structure with the result that rates may be higher in areas where potential competition does not exist?
>
> A. Yes. Ameritech Michigan has filed an application to restructure its basic local exchange rates and services in Michigan [referring to the Application of Ameritech Michigan in Case No. U-11039 to restructure its basic local exchange rates and services][6]. The application proposes to condense the current seven rate groups into three access areas on the basis of the number of access lines per square mile in exchanges. The resulting proposed restructure of rate groups result in Access Areas A and B, where a potential competitive alternative exists, and Access Area C, where a potential competitive alternative does not exist. The application proposes that Access Area C will have the highest rates, and Access Area A will have the lowest rates. Furthermore, ACI has reflected the Access Areas and rate restructure proposed by Ameritech Michigan in Case No. U-11039 in the illustrative tariff attached to its application as Exhibit C.[7]

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[6]On May 10, 1996, in its Opinion and Order in Case No. U-11039, the Commission approved Ameritech Michigan's application to restructure its basic local exchange rates and services in Michigan. The Commission's approval therefore removes this concern as a mere hypothetical.

[7]The illustrative tariff was admitted into evidence in this case as Exhibit A-27.

5 Tr 916-917 Ameritech's steps to restructure its rate groups in conjunction with Ameritech's creation of a duplicate affiliate to resell intraLATA and basic local exchange service would effectively allow Ameritech to engage in a form of price discrimination, enabling Ameritech Michigan to cross-subsidize its affiliate Ameritech Communications' entry and emergence in the market for local exchange service market. Dr. Teske testified on how this would manifest itself and how the public interest would be harmed:

> Q. Assuming that Ameritech Michigan and ACI both adopt the Access Area and rate restructure proposed in Case No. U-11039, how would the public interest be harmed?
>
> A. The primary concern results from the <u>simultaneous</u> creation of a duplicate affiliate to resell intraLATA and basic local exchange service, a proposed Access Area rate structure that divides the state into areas on the basis of whether a potential competitor exists, and the absence of information about the rates, terms, and conditions of the basic local exchange resale arrangements between Ameritech Michigan and ACI
>
> ACI would be able to obtain more favorable resale arrangements form Ameritech Michigan for basic local exchange service than any other new entrant. Even assuming that Ameritech Michigan has a resale tariff on file, unless specifically prohibited, it has every incentive to provide more favorable rates, terms, and conditions to its affiliate through Individual Customer Basis (ICB) contracts. The result would be a dual rate structure with unreasonably higher rates than customers in Access Area A. In addition to the absence of a competitive alternative, as well as the benefits that result from competition, rural Michigan ratepayers would be burdened with higher monopoly rates than rates in other areas to finance Ameritech Michigan's anticompetitive capture of urban basic local exchange markets.

5 Tr 917-918 (Emphasis in original)

The possibility of cross-subsidization between Ameritech Michigan and its affiliate Ameritech Communications would not be limited to situations where Ameritech Communications is mere a local service reseller. If Ameritech Communications becomes a facilities-based local exchange service provider, there are similar concerns of cross-subsidization which would harm customers and which would allow Ameritech Communications to gain an unfair competitive advantage in the markets for local exchange and interLATA service. First, revenues derived from the provision of basic local exchange service by Ameritech Michigan may be used to cross-subsidize Ameritech Communications' facilities-based local exchange service, with the result that Ameritech Communications' basic local exchange service could be priced below its total service long-run incremental cost (TSLRIC). *5 Tr 918* In fact, there is a substantial incentive by Ameritech to undertake this type of cross-subsidization to reduce Ameritech Communications' service prices below its TSLRIC. Dr. Teske explains:

> If ACI is able to undercut Ameritech Michigan's basic local exchange service prices in those areas by pricing below total service long-run incremental cost, then Ameritech Michigan will lose its local exchange customers in those areas, not to the competitor, but to its own affiliate. Though Ameritech would lose money in the short-run, they could make this up by charging higher rates in other areas, and by the potential for packaging local exchange service with other service. This type of anticompetitive behavior is classic predatory pricing for the purpose of undercutting potential competitors and driving them out of business. The result would be that Ameritech would retain its basic local exchange service monopoly in areas of the state even where potential competitive alternatives exist.

5 Tr 919 (Emphasis added) As discussed earlier, Ameritech Communications' incorporation of Ameritech Michigan's rate restructuring proposal filed in Case No. U-11039 provides Ameritech with the opportunity to engage in this strategic differential pricing. Without adequate safeguards against such abuse, Ameritech would be able to unreasonably discriminate between ratepayers in the same rate classes and would allow Ameritech to preserve its dominant share in the market for basic local exchange.

Second, Ameritech Michigan would be able to sell or transfer to its affiliate Ameritech Communications capital assets which were financed with regulated service revenues at a more favorable amount than the replacement value for purposes of providing the regulated local exchange service. Again Ameritech has a distinct incentive to make such inter-affiliate transfers since Ameritech could profit in the long-run in that Ameritech could reduce the price of its basic local exchange service below TSLRIC in its areas where potential competition might exist. This would serve to help Ameritech retain its monopoly market share. *5 Tr 920-921*

Finally, Ameritech Communications' status as a duplicate facilities-based local exchange service provider along with Ameritech Michigan may in the long-run allow Ameritech Communications to establish more favorable access charges for its long-distance customers than Ameritech Michigan's access rates. Indeed, Ameritech's intention to establish Ameritech Communications as a separate affiliate that provides both local and long-distance helps to facilitate this potential cross-subsidization. Dr. Teske explains the reasons for this strategy:

> First, assuming that ACI becomes a facilities-based provider of basic local exchange service, Ameritech will avoid all requirements to impute access charges charged to the affiliate for local exchange access to its own services, because ACI would be providing local exchange access to itself for completion of long-distance traffic.
>
> Second, ACI would have the ability to selectively offer its bundled local and long-distance service in areas where a competitive choice for basic local exchange service exists. The existence of a duplicate affiliate to provide local exchange service will allow ACI to offer more favorable access charges, perhaps on an ICB basis, to only those customers who have a competitive alternative, and who purchase long-distance service from ACI. All other long-distance customers in

> Michigan will be customers of interexchange (IXCs) other than ACI, and must pay Ameritech Michigan's less favorable access rates passed through to them by IXCs.

5 Tr 921-922

Such behavior would be contrary to the public interest. Ameritech Michigan would be able to offer higher explicit access rates to its affiliate's competitors, IXCs, than ACI would implicitly offer to its own long-distance customers through their interLATA rates. In addition, the creation of duplicate affiliate providers of local exchange service would result in Michigan customers paying different and unreasonably discriminatory access rates in their interLATA rates. *5 Tr 922* This would likely result in substantial harm to consumers and will significantly impede the growth of greater competition in the local and long-distance service markets.

Conclusion and Request for Relief

The evidence in this proceeding strongly demonstrates the inherent concerns arising from the establishment by a monopoly of a duplicate affiliate provider of local exchange services. Such a proposition is fraught with the danger of cross-subsidization between affiliates, preferential treatment by the monopoly provider in favor of its affiliate and the opportunity for discriminatory pricing. The problem with Ameritech Communications' application in this proceeding is that it amplifies rather than attempts to resolve these concerns. For example, Ameritech's witnesses have testified as to the cavalier manner in which financial and personnel resources have been flowing between these affiliates. Furthermore, Ameritech Communications' representations of its motives as to why it seeks a license for local exchange service are not genuine, and its presentation in support of its case, specious and inadequate. As was noted by the various independent witnesses in this case, the mere existence of a separate affiliate is inadequate to protect against anticompetitive behavior on the part of a monopoly provider in the absence of separate affiliate transactions safeguards. It is clear from the record in this proceeding that Ameritech Communications has not provided this Commission with enough information to ensure against this potential abuse and that its true objection is to leap into the long distance market while avoiding the necessary scrutiny as to its compliance with statutory competitive requirements. TCG-Detroit has been inclined not to advocate the rejection of licenses for telecommunication services in various other proceedings; however, Ameritech Communications' presentation in this case is so troubling that TCG-Detroit could not countenance an approval by the Commission in this case, since such an approval would clearly be contrary to the public interest. Hence, TCG-Detroit recommends that Ameritech Communications' application for a license to provide basic local exchange service in the service territories of Ameritech Michigan be denied.

Respectfully submitted,

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Dated: June 17, 1996

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

Application of Ameritech Communications, Inc. for a License to Provide Basic Local Exchange Service in Ameritech Michigan and GTE North, Inc. Exchanges in Michigan.	)	MPSC Case No. U-11053

PROOF OF SERVICE

STATE OF MICHIGAN)
) SS:
COUNTY OF INGHAM)

I, Cathy Dawn Martin, being duly sworn, depose and say that on June 17, 1996, I served a copy of the Initial Brief of TCG-Detroit, Inc. upon:

See attached service list.

Except as otherwise noted on the attached list, service was accomplished by facsimile or hand delivery as denoted on the service list.

Cathy Dawn Martin

Cathy Dawn Martin

Subscribed and sworn to before me
this 17th day of June, 1996.

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